

Message Text

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ORIGIN EA-09

INFO OCT-01 ISO-00 EB-08 COME-00 AID-05 CIAE-00 FRB-03
INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 DODE-00 PM-05 H-01
L-03 NSC-05 PA-01 PRS-01 SS-15 STR-04 FTC-01
/088 R

DRAFTED BY EA/TIMBS:ARDORNHEIM:CCH
APPROVED BY EA - MR. HEGINBOTHAM
EB/IFD/OIA - MR. SMITH (INFO)
-----095391 050041Z /64
R 033248Z AUG 77
FM SECSTATE WASHDC
TO AMEMBASSY JAKARTA

C O N F I D E N T I A L STATE 182634

E.O. 11652:GDS

TAGS: ETRD, EINV, ID

SUBJECT:IBM IN INDONESIA

REFS: A. JAKARTA 1001 B. JAKARTA 9564

1. DAN MCGURL, DIRECTOR OF OPERATIONS FOR FAR EAST, IBM WORLD TRADE AMERICAS FAR EAST CORP, AND PETER HOFFMEISTER, FROM WASHINGTON OFFICE OF IBM WORLD TRADE CORP, CALLED ON DEPUTY ASSISTANT SECRETARY HEGINBOTHAM JULY 27 TO DISCUSS IBM'S PROBLEMS IN COMPLYING WITH THE GOI'S LAW NO. 6 OF 1968.

2. FOLLOWING IS MCGURL'S ASSESSMENT OF IMPORTANCE OF IBM'S OPERATIONS IN INDONESIA. THESE OPERATIONS GROSS ABOUT ONE TENTH OF ONE PERCENT OF IBM'S ANNUAL SALES WORLDWIDE, BUT THEY ARE NEVERTHELESS VALUED FOR THEIR CONFIDENTIAL

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GROWTH POTENTIAL AND FOR INVESTMENT OF IBM TIME AND EFFORT THEY REPRESENT. ABOUT 85 PERCENT OF IBM EQUIPMENT IN INDONESIA (BY VALUE) IS THERE UNDER LEASING CONTRACTS (AND STILL UNDER IBM OWNERSHIP) AND IS VALUED AT ABOUT 8 MILLION DOLS (OR, ONE TWENTIETH OF ONE PERCENT OF IBM'S CONSOLIDATED ASSETS). RECOVERY OF "INVESTMENT" IN LEASED EQUIPMENT USUALLY TAKES FOUR OR FIVE YEARS.

3. IBM SEES ITS COMPETITION IN INDONESIA AS BROADLY

REPRESENTED AND SERIOUS. TAKEN TOGETHER, SALES RECORD OF COMPETITORS IS COMMENDABLE. SO FAR, HOWEVER, INDIVIDUAL COMPETITOR SUCCESSES HAVE NOT MATCHED IBM'S. TO DATE NO OTHER COMPUTER COMPANY HAS BEEN WILLING OR ABLE TO GO INTO LEASING ON LARGE SCALE AND THUS TO MAKE KIND OF LONG-TERM INVESTMENT IN INDONESIAN MARKET THAT IBM HAS DONE. FUJITSU IS THERE AND WILL PUSH AHEAD AGGRESSIVELY, BUT ITS LOCAL ORGANIZATION IS NOT YET WELL ESTABLISHED. JAPANESE GOVERNMENT HAS STIMULATED FINANCIAL SUPPORT OF COMPUTER COMPANY LEASING OPERATIONS WITHIN JAPAN, BUT TO DATE IT HAS NOT PROMOTED FINANCIAL SUPPORT OF COMPUTER LEASING OVERSEAS TO SAME DEGREE.

4. IBM HAS NEVER DEVIATED FROM ITS POLICY OF 100-PERCENT OWNERSHIP OF ITS FOREIGN LEASING AND MAINTENANCE OPERATIONS. AMONG OTHER REASONS, LOCAL BUSINESSMEN TEND TO HAVE DIFFERENT OBJECTIVES, PUTTING GREATER WEIGHT THAN IBM ON SHORT-TERM GAINS; THEY ARE UNWILLING TO ACCEPT INITIAL LOSSES OF NEW VENTURES.

5. THERE ARE SPECIAL SITUATIONS. IN COMMUNIST EUROPEAN COUNTRIES AND USSR IBM MAINTAINS REPRESENTATIVE OFFICES, WHICH PROMOTE SALES ONLY (NO LEASING) AND HANDLE REQUESTS
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FOR SERVICE. SALES CONTRACTS, HOWEVER, ARE SIGNED OUTSIDE THESE COUNTRIES. LAST-RESORT MAINTENANCE BACKUP COMES FROM IBM'S WHOLLY OWNED SUBSIDIARY IN VIENNA. UNIQUELY IN YUGOSLAVIA, WHERE IBM COMPANY AND ITS LEASED COMPUTERS WERE NATIONALIZED, MAINTENANCE IS NOW DONE BY LOCAL IBM AGENT; HOWEVER, MOST DEMANDING MAINTENANCE IS STILL FURNISHED FROM VIENNA. SIGNIFICANTLY, GOVERNMENTS IN POLAND, CZECHOSLOVAKIA, HUNGARY, AND BULGARIA HAVE FOUND THIS ARRANGEMENT UNSATISFACTORY AND HAVE MADE OVERTURES TO IBM LOOKING TO ESTABLISHMENT OF FULL IN-COUNTRY IBM SYSTEMS ENGINEERING SUPPORT. MCGURL JUDGED THAT IBM MANAGEMENT WOULD CONTINUE TO INSIST ON 100-PERCENT CONTROL AS CONDITION FOR ENTRY INTO EAST EUROPEAN COUNTRIES. MEANWHILE, IBM APPLIES "SALES ONLY" POLICY, AS IT WOULD ALSO IN CHINA.

6. IBM IS APPROACHING CHINA MARKET VERY CAUTIOUSLY. ONE SMALL COMPUTER SALE IS PENDING, AS PART OF A CONTRACT TO BE SIGNED WITH CHINA BY ANOTHER FIRM. IBM WOULD TRAIN CHINESE TO MAINTAIN THIS COMPUTER AND WOULD BE PREPARED TO PROVIDE OFFSHORE SUPPORT ON COST-PLUS-FEE BASIS, AS IT DOES IN EASTERN EUROPE.

7. IRAN PURCHASES IBM COMPUTERS THROUGH OFFSHORE SALES AND HAS CONTRACTED FOR MAINTENANCE ONLY WITH IBM IRAN.

8. INDIA HAS TRIED TO FORCE LOCAL EQUITY PARTICIPATION

UPON IBM FOR ABOUT TWO YEARS. IBM HAS PROPOSED A SPLITTING OF ITS WHOLLY OWNED SUBSIDIARY INTO NEW CORPORATE ENTITIES. ONE, WITH 40 PERCENT INDIAN EQUITY, WOULD OPERATE DATA PROCESSING CENTER AND SOFTWARE. OTHER, RETAINING 100 PERCENT IBM OWNERSHIP, WOULD CONTINUE TO ASSEMBLE CERTAIN COMPUTERS LOCALLY FOR EXPORT AND WOULD ALSO IMPORT, LEASE AND MAINTAIN COMPUTERS MADE IN US. IBM HAS ARGUED THAT INDIAN LAW PERMITS FOREIGN COMPANIES MANUFACTURING LOCALLY FOR EXPORT TO RETAIN 100 PERCENT CONFIDENTIAL

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CONTROL. GOI HAS SO FAR TAKEN NO ACTION ON IBM PROPOSED REORGANIZATION.

9. IN JAPAN IBM WAS ABLE TO INDUCE GOVERNMENT TO AGREE TO IBM'S FULL CONTROL OF ITS LOCAL OPERATION IN EXCHANGE FOR JAPANESE INDUSTRY ACCESS TO ITS PATENTS. NATIONAL CASH REGISTER AND TEXAS INSTRUMENTS WERE ALSO ABLE TO SECURE SIMILAR APPROVALS FROM GOJ.

10. SERIOUSNESS OF ISSUES RAISED FOR IBM BY GOI'S EFFORTS TO APPLY LAW NO. 6 IS EVIDENCED BY FACT THAT IBM BOARD CHAIRMAN AND ITS CORPORATE MANAGEMENT COMMITTEE HAVE STUDIED SITUATION AND HAVE REACHED A FIRM DECISION. COMPANY VALUES PREEMINENT POSITION IT HAS CREATED FOR ITSELF IN A POTENTIALLY SIGNIFICANT MARKET. IT SINCERELY HOPES IT CAN CONTINUE DOING BUSINESS IN INDONESIA UNDER PROVISION OF LAW NO. 6 WHICH PERMITS FOREIGN CONTROL OF COMPANIES NOT ENGAGED IN "TRADE" OR MANUFACTURING. HOWEVER, IBM IS FULLY PREPARED TO TAKE PAINFUL DECISION TO WALK AWAY FROM INDONESIA, IF GOI DETERMINE THAT P.T. IBM INDONESIA IS A FOREIGN COMPANY ENGAGED IN "TRADE" AND MUST THEREFORE BE REESTABLISHED AS AN INDONESIAN-CONTROLLED ENTERPRISE FROM JANUARY 1 NEXT. THIS WOULD BE FIRST TIME IBM HAS VOLUNTARILY RELINQUISHED ITS "INVESTMENT" (EQUIPMENT, TRAINING PROGRAM, SERVICES, ETC.) IN ANY COUNTRY. DECISION MADE IN FULL EXPECTATION THAT FUJITSU WILL LEAP AT CHANCE TO DOMINATE INDONESIAN MARKET AND THAT CHANCES OF IBM REENTRY WOULD BE SLIM. MCGURL ALSO ACKNOWLEDGED THAT WITH ITS IN-COUNTRY PRESENCE GONE, IBM COULD NOT CONTINUE AS AN EFFECTIVE COMPETITOR IN INDONESIAN MARKET THROUGH SALES ALONE. BACKUP MAINTENANCE FROM OUTSIDE COUNTRY WOULD BE INCONVENIENT AND PROHIBITIVE IN COST FOR CUSTOMER. MOREOVER, FUJITSU COULD BE EX-CONFIDENTIAL

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PECTED TO PUSH ITS SALES AND POSSIBLY EVEN LEASING VIGOROUSLY, WITH GOJ FINANCIAL BACKING, AND TO ESTABLISH ITS OWN IN-COUNTRY MAINTENANCE COMPANY (UNDER NOMINAL INDONESIAN CONTROL), IN ORDER TO DOMINATE A POTENTIALLY

LARGE SEGMENT OF ITS "NATURAL" MARKETING REGION. ANTICIPATED THAT INDIA MIGHT FOLLOW INDONESIAN LEAD.

11. QUITE SIMPLY, IBM MANAGEMENT IS NOT PREPARED IN FINAL ANALYSIS TO COMPROMISE ITS MARKETING PRINCIPLES IN A COUNTRY OF MINIMAL SIGNIFICANCE TO ITS GLOBAL OPERATIONS. IT IS WILLING TO LOSE OUT IN SEVERAL SMALL-MARKET COUNTRIES TO JAPANESE COMPETITION IN ORDER TO MAINTAIN INTEGRITY OF COMPANY POLICY, WHOSE BENEFITS IBM BELIEVES WILL BECOME APPARENT TO CUSTOMERS IN LONG RUN.

12. MCGURL ALSO SPECULATED ON NATURE OF TRANSITION PERIOD FROM DEPARTURE OF IBM TO FUJITSU'S EVENTUAL DOMINANCE OF MARKET IN COURSE OF FEW YEARS. IBM WOULD OFFER INDONESIAN LESSORS RIGHT TO BUY THEIR COMPUTERS; BUT WHO WOULD FINANCE PURCHASES? EX-EMPLOYEES OF P.T. IBM INDONESIAN MIGHT BE RE-FORMED INTO NEW SERVICE COMPANY. SPARE PARTS WOULD BE EXPENSIVE, HOWEVER; AND THAT 20 PERCENT OF HIGHLY TECHNICAL MAINTENANCE, NOW DONE BY IBM, WOULD HAVE TO BE PERFORMED BY IMPORTED IBM PERSONNEL AT RELATIVELY HIGH COST. GONE WOULD BE ACCESS TO IBM'S SPECIAL DIAGNOSTIC SERVICES IN US VIA SATELLITE. IN GENERAL, IT WOULD BE A PAINFUL PROCESS TO ENABLE GOI TO COPE WITHOUT IBM IN-COUNTRY LEASING/MAINTENANCE.

13. IN A POSITIVE VEIN, HEGINBOTHAM SUGGESTED SEVERAL ACTIONS IBM MIGHT PURSUE TO PREVENT IMPASSE AND ULTIMATE IBM WALK-AWAY, WHICH IBM MANAGEMENT STILL WISHES TO AVOID. HE ENDORSED IBM'S APPEAL FOR SUPPORT FROM TWELVE OF ITS BEST CORPORATE CUSTOMERS IN INDONESIA AND FROM FOUR GOI MINISTRIES. HEGINBOTHAM MENTIONED SOEHOED AS A SYMPATHETIC PROBLEM-SOLVER, WHOM IBM MIGHT WISH TO CONTACT.
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INDONESIANS COULD ALSO BE LEFT WITH CERTAIN SOBERING THOUGHTS:

A) IF IBM DEPARTS, INDONESIA'S DESIRE TO MAINTAIN BALANCE AND INDEPENDENCE OF CHOICE IN TOTAL COMPUTER FIELD WOULD BE LOST AS THAT MARKET WOULD BE QUICKLY AND PERMANENTLY DOMINATED BY JAPANESE; IF IBM STAYS, INDONESIANS CAN EXPECT INCREASING IBM-FUJITSU COMPETITION;

B) WITH VERY HIGH OPPORTUNITY COST OF CAPITAL IN INDONESIA, NO ONE CAN EXPECT AN INDONESIAN COMPUTER FIRM TO TIE UP LARGE SUMS REQUIRED FOR LEASING INVESTMENTS, TRAINING AND CUSTOMER SERVICE, FOR RELATIVELY SLOW PAY-OUT; IBM, WITH A MUCH LOWER CAPITAL OPPORTUNITY COST, CAN AFFORD TO DO THESE THINGS AND AT SAME TIME OFFER TO EXCHANGE LEASED COMPUTERS, BEFORE FULL DEPRECIATION, FOR NEWER EQUIPMENT; THIS LINE OF ARGUMENT MAY APPEAL TO BARLI HALIM'S THEORETICAL EXPERTISE;

C) IF IBM PULLED OUT, AMERICAN INVESTORS WOULD NOT ASK

FOR DETAILS; THEY WOULD SEE THIS DEVELOPMENT, ON TOP OF PREVAILING IMPRESSION OF ADVERSE INDONESIAN INVESTMENT CLIMATE, AS DRAMATICALLY CONFIRMING CASE; AND THERE WOULD BE CONSEQUENT INCREASE IN DOMINANCE OF JAPANESE INVESTORS.

HEGINBOTHAM ALSO SUGGESTED THAT MCGURL IDENTIFY FOR INDO-NESIANS ANY MAJOR IBM LINE OF BUSINESS VALUABLE TO INDO-NESIANS WHICH COMPETITORS CANNOT SUPPLY (E.G., REAL-TIME COMPUTER SERVICES TO HOUSTON VIA SATELLITE FOR SEISMIC DATA ANALYSIS). IBM MIGHT EMPHASIZE ITS SERVICE POTENTIALLY RELEVANT TO INDONESIA AS LEADER IN ASEAN
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COMMUNICATIONS.

14. MCGURL WAS PLEASED WITH DEPARTMENT'S INTEREST IN HIS COMPANY'S PROBLEM AND WENT OUT OF HIS WAY TO EXPRESS IBM'S APPRECIATION FOR AMBASSADOR'S VERY HELPFUL ROLE IN IN JAKARTA. HE SOUGHT AND RECEIVED REASSURANCE THAT AMBASSADOR WOULD BE ABLE TO INTERCEDE WITH GOI ON IBM'S BEHALF. WE SUGGESTED PITCH WOULD PROBABLY BEST BE MADE IN TERMS OF INDONESIA'S OWN SELF-INTEREST.

15. WHILE REFTEL A SUGGESTS THAT PRAWIRO PREFER TO TREAT IBM PROBLEM AS A LEGAL QUESTION, EMBASSY MAY FIND APPROPRIATE OCCASIONS TO PASS ALONG TO KEY GOI OFFICIALS CERTAIN PRACTICAL, NON-LEGAL THOUGHTS CONTAINED IN PARAS ABOVE.

16. AFTER HEGINBOTHAM MEETING WITH MCGURL, IBM REPRESENTATIVES ALSO ADVISED TO DISCUSS PROBLEM WITH AMBASSADOR ROESMIN. IDEA WAS WELL RECEIVED. IN THIS CONNECTION, GEORGE BENSON INFORMS US AMBASSADOR TOOK UP IBM CASE WITH WIDJOJO IN BENSON'S PRESENCE IN NEW YORK, STRESSING SPECIAL NATURE OF CASE AND SOPHISTICATION OF EQUIPMENT INVOLVED. WIDJOJO LISTED WITHOUT COMMENT. CHRISTOPHER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 22-Sep-1999 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FOREIGN INVESTMENTS, TRADE VISITS, MEETINGS
Control Number: n/a
Copy: SINGLE
Sent Date: 03-Aug-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977STATE182634
Document Source: ADS
Document Unique ID: 00
Drafter: EA/TIMBS:ARDORNHEIM:CCH
Enclosure: n/a
Executive Order: 11652 GDS
Errors: n/a
Expiration:
Film Number: D770280-0463
Format: TEL
From: STATE
Handling Restrictions: n/a
Image Path:
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Legacy Key: link1977/newtext/t197708117/baaaetkm.tel
Line Count: 262
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, TEXT ON MICROFILM
Message ID: 8288b350-c288-dd11-92da-001cc4696bcc
Office: ORIGIN EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: A. JAKARTA 1001 B. JAKARTA 9564
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 19-Nov-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1445093
Secure: OPEN
Status: NATIVE
Subject: IBM IN INDONESIA
TAGS: ETRD, EINV, BTRA, ID, US, IBM, (MCGURL, DAN), (HOFFMEISTER, PETER), (HEGINBOTHAM) (HEGINBOTHAM)
To: JAKARTA
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/8288b350-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009